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FISCAL IMPACT STATEMENT

LS 6944 **NOTE PREPARED:** Jan 13, 2006
BILL NUMBER: HB 1007 **BILL AMENDED:**

SUBJECT: Various Business Tax Changes.

FIRST AUTHOR: Rep. Harris T **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X **GENERAL** **IMPACT:** State & Local
X **DEDICATED**
FEDERAL

Summary of Legislation: ***Single-Sales-Factor Apportionment:*** This bill increases, over four years, for purposes of the Adjusted Gross Income Tax, the sales factor used to apportion business income. The bill eliminates the property factor and payroll factor that are also used in apportioning income for taxable years beginning after December 31, 2010.

Small Business Innovation and Technology Grant Program: This bill establishes the Small Business Innovation and Technology Grant Program to provide grants of up to $15,000 from the Twenty-first Century Research and Technology Fund to small businesses that apply for federal Small Business Innovation Research and Technology Transfer Grants. The bill provides that the Economic Development Corporation administers the program. It makes an appropriation.

Transfer of Credits Against State Tax Liability: This bill also provides that a person entitled to claim a state tax liability credit may transfer all or part of the right to claim the state tax liability credit to another person. The bill eliminates existing restrictions on the right to assign certain state tax liability credits. It provides, with respect to certain tax credits, that for a pass through entity that is treated as an S corporation for federal income tax purposes, a shareholder's share of a tax credit is determined in the manner provided for determining an S corporation shareholder's share of credits under the Internal Revenue Code. The bill also provides, with respect to certain tax credits, that for a pass through entity that is treated as a partnership for federal income tax purposes, a partner's or member's share of a tax credit is determined in the manner provided for determining a partner's share of credits under the Internal Revenue Code.

Hoosier Business Investment Tax Credit (HBITC): The bill deletes the January 1, 2008, deadline for a purchase of motion picture or audio production equipment to be eligible as a qualified investment for purposes of the Hoosier Business Investment Tax Credit. The bill extends by five years (from December 31, 2007, to December 31, 2012) the date by which a qualified investment must be made in order to be eligible for the HBITC. The bill also provides for automatic extensions of that date in five-year increments unless the General Assembly enacts a law that terminates the automatic extensions.

Effective Date: July 1, 2006; January 1, 2007.

Explanation of State Expenditures: ***Small Business Innovation and Technology Grant Program:*** The bill establishes the Small Business Innovation and Technology Grant Program to be administered by the Indiana Economic Development Corporation (IEDC). The grant program would first be effective in FY 2007. The bill provides for an annual appropriation to the IEDC from the 21st Century Research and Technology Fund for purposes of the grant program. The bill limits to $1.5 M the total grants that may be provided in a fiscal year by the IEDC.

The program is created to provide grants of up to $15,000 to qualified small businesses to defray the cost of applying for grants from two federal programs: (1) the Small Business Innovation Research (SBIR) Program and (2) the Small Business Technology Transfer (STTR) Program. The small business must have all or substantially all of its employees and operations in Indiana, and conduct all or substantially all of the research for the SBIR or STTR project in Indiana. The annual appropriation could fund 100 grants of $15,000 each.

Under current statute, the 21st Century Research and Technology Fund is administered by the IEDC. Appropriations to the Fund from the Tobacco Master Settlement Agreement Fund total $37.5 M in FY 2006 and $37.5 M in FY 2007. As of January 9, 2006, the Fund had a balance of $36.8 M. The Fund had an ending balance in FY 2005 totaling about $26.4M. In FY 2003 and FY 2004, the 21st Century Research and Technology Fund Board provided matching grants of up to $100,000 for Phase 1 SBIR and STTR grant recipients in Indiana. (The maximum SBIR and STTR Phase 1 Grant is $100,000.) The Fund Board awarded $3 M per year in matching grants in FY 2004 and FY 2005. The IEDC Board is continuing the grant program in FY 2006, and is currently in the final stages of awarding these matching grants.

Background: The Small Business Innovation Research (SBIR) Program and the Small Business Technology Transfer (STTR) Program are administered by the U.S. Small Business Administration. The programs provide grant funding for small business research and development leading to new or innovative products or technology that has the potential for commercialization. The grant funding is set aside from the research and development budgets of various federal agencies (i.e., Department of Agriculture, Department of Defense, and Department of Energy). To qualify for grant funding, a business must be at least 51% American-owned and independently operated with no more than 500 employees. The STTR Program requires the small business to collaborate with an American nonprofit research institute. Small businesses that receive grants retain the rights to any product or technology developed and are encouraged to commercialize the technology. A small business may receive up to $100,000 to explore the feasibility of the new product or technology, and up to an additional $750,000 to conduct the research and development and evaluate the potential for commercializing the product or technology. In 2004, 35 SBIR grants were awarded to Indiana firms totaling about $12.6 M; and 8 STTR grants were awarded to Indiana firms totaling about $3.5 M. Nationally, 6,348 SBIR grants totaling $2,014.6 M, and 842 STTR grants totaling $208.7 M, were awarded in 2004.

Department of State Revenue (DOR): The DOR would incur some administrative expenses as a result of allowing taxpayers to transfer state tax liability credits. The bill requires the DOR to administer the tax credit transfer process and establish a numbering and reporting system for tax credit transfers.

The transition to a single-sales-factor apportionment formula to determine the Indiana Adjusted Gross Income Tax will affect the administration of the tax.

The DOR will have to revise tax forms, instructions, and computer programs for purposes of tax credit transfers, changes in the Enterprise Zone Investment Cost Credit and the changes in the single-sales-factor apportionment formula.

Explanation of State Revenues: ***Single-Sales-Factor Apportionment: Summary**:* The bill provides for a 5-year phaseout (from 2007 to 2011) of the payroll and property factors used to apportion a corporate taxpayer's adjusted gross income (AGI) to Indiana under the AGI Tax. Beginning in 2011, AGI of corporate taxpayers would be apportioned solely on a single sales factor. Based on taxpayer simulations and the current forecast of corporate revenue collections, the change to single-sales-factor apportionment is estimated to result in a net decrease of revenue from the corporate AGI Tax as outlined in the table below.

Fiscal Impact	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Low Range	($2.0 M)	($6.1 M)	($10.4 M)	($14.9 M)	($25.3 M)	($34.0 M)
High Range	($3.1 M)	($10.0 M)	($17.6 M)	($26.2 M)	($45.9 M)	($63.9 M)

Background: The bill phases out the payroll and property factors for purposes of computing corporate Adjusted Gross Income (AGI) Tax. The apportionment formula is used to determine Indiana adjusted gross income for corporations whose income is derived from sources both within and outside Indiana. Currently, a three-factor apportionment formula is used including property, payroll, and sales (also called receipts) to allocate business income to the state. The sales factor is double-weighted so that the payroll and property factors combined represent 50% of the apportionment factor, with sales representing the remaining 50%. The current apportionment formula is shown below.

$$\left[\frac{Indiana\ \ Property}{Total\ \ Property} + \frac{Indiana\ Payroll}{Total\ Payroll} + 2*\left(\frac{Indiana\ Sales}{Total\ Sales}\right)\right] \div 4$$

The bill phases out the payroll and property factors by 10% each year from 2007 to 2011. The phaseout schedule is as follows:

	Sales Factor Weight	**Combined Weight of Payroll and Property Factors**
Current	50%	50%
2007	60%	40%
2008	70%	30%
2009	80%	20%
2010	90%	10%
2011 and after	100%	0%

After the phaseout of the payroll and property factors in 2011, a corporation's income would be allocated to the state based on its Indiana sales as a proportion of its total sales in the United States. The single-sales-factor apportionment formula is presented below:

$$\frac{\textit{Indiana Sales}}{\textit{Total Sales}}$$

Corporate AGI taxes are distributed to the General Fund. In FY 2005, $608.4 M was collected in corporate AGI Taxes.

Methodology: The fiscal impact is estimated based on a taxpayer simulation using 2003 Corporate AGI taxpayer information (from the IT 20 returns) and recalculating tax liabilities based on the changes in the apportionment formula. The revenue estimates above are based on the first year that corporate taxpayers were taxed solely on adjusted gross income and not gross receipts. *The extent to which this change in tax policy will alter the corporate tax base and future revenue collections is unknown*. Based on the simulation, the net revenue loss from moving to single-sales-factor apportionment is not the result of all corporate taxpayers experiencing some decline in tax liability. Rather, it is the additive result of some taxpayers experiencing a decrease in tax liability and others experiencing an increase in tax liability that fails to fully offset the total of the tax reductions. The simulations using 2003 taxpayer data resulted in about 2,300 taxpayers experiencing a decrease in net tax liability after credits and about 4,700 experiencing an increase in net tax liability after credits. The simulations also resulted in nearly 28,500 taxpayers being unaffected by the change to single-sales-factor apportionment.

The low-range estimate is the net impact on tax liabilities assuming that the taxpayers experiencing tax liability increases due to single-sales-factor apportionment would not have additional NOL (net operating loss) deduction amounts or tax credit amounts to reduce these higher tax liabilities. Thus, they would utilize the same NOL deduction amounts and tax credit amounts as reported in 2003. The high range is the net impact assuming that some taxpayers experiencing tax liability increases due to single-sales-factor apportionment will have sufficient additional NOL deduction amounts and tax credits to reduce these higher tax liabilities. *It is important to note that the net revenue loss could potentially exceed the high range if all of the taxpayers experiencing increased liabilities are able to utilize additional NOL deduction amounts or tax credits to reduce these higher tax liabilities to zero.*

The tables below summarize the results of the 2003 taxpayer simulations. The table below shows the extent that single-sales-factor apportionment would have affected 2003 Indiana **apportioned income**. A total of 35,396 taxpayers were used for the simulation, with 7,128, or 20%, experiencing an increase in Indiana apportioned income and 4,034, or 11%, experiencing a decrease in apportioned income. The net effect for these taxpayers was a 6% decrease in Indiana apportioned income. A total of 24,234, or 69%, of all the regular C corporate taxpayers experienced no change in Indiana apportioned income.

Effect of Single-Sales-Factor (SSF) Apportionment on Indiana Apportioned Income - 2003 Tax Data*						
Apportioned Income	**# Affected**	**Apportioned Income - Current**	**Apportioned Income Under SSF**	**Difference**	**% Diff.**	**Avg. Diff.**
Increase	7,128	$1,703.9 M	$2,265.0 M	$561.1 M	33 %	$78,718
Decrease	4,034	$2,287.0 M	$1,473.1 M	($813.9 M)	(36%)	($201,751)
Total Affected	11,162	$3,990.9 M	$3,738.1 M	($252.8 M)	(6%)	($22,645)
No Change	24,234	$1,290.9 M	$1,290.9 M	$0	0	$0

* This table is the effect on corporate taxpayers fully phased-in single-sales-factor apportionment.

The next table summarizes the impact that single-sales-factor apportionment would have had on 2003 **net tax liabilities** (after credits) for the same group of corporate taxpayers. The simulations resulted in 4,678, or 13%, of the taxpayers experiencing a tax increase and 2,309, or 7%, of the taxpayers experiencing a tax decrease. The net decrease in tax liability for all affected taxpayers would have been about 4%. A total of 28,409, or 80%, of the regular C corporate taxpayers would have experienced no change in net tax liability after credits.

Effect of Single-Sales-Factor (SSF) Apportionment on Net Tax Liability After Credits - 2003 Tax Data*							
Tax Liability	**# Affected**	**# of Payers**	**Current Tax**	**Tax Under SSF**	**Difference**	**% Diff.**	**Avg. Diff.**
Increase	4,678	3,950	$116.0 M	$163.6 M	$47.6 M	41%	$10,683
Decrease	2,309	2,136	$156.9 M	$99.5 M	($57.4 M)	(37%)	($13,473)
Total Affected	6,907	6,086	$272.9 M	$263.1 M	($9.8 M)	(4%)	($6,568)
No Change	28,409	8,819	$87.2 M	$87.2 M	$0	0	$0

* This table is the effect on corporate taxpayers fully phased-in single-sales-factor apportionment.

The last table shows the shift in the share of AGI taxes that would have been paid in 2003 by the three groups of corporations. The simulation results indicate that the share of taxes paid by taxpayers experiencing an increase in liability goes from 32% to 47%. The share for corporations experiencing a reduction in tax liability falls from 44% to 28% of the total.

Taxpayers who's taxes...	% Share under Current Law	% Share under Single Sales
Increase	32%	47%
Decrease	44%	28%
are Unaffected	24%	25%

Transfer of Credits Against State Tax Liabilty: The bill would reduce state Adjusted Gross Income (AGI) Tax, Insurance Premiums Tax, and Financial Institutions Tax liabilities of individual and corporate taxpayers that obtain unused tax credits from other individual and corporate taxpayers. Data is unavailable indicating the amount of outstanding tax credits that are not used from year to year. Assuming unused credit amounts would eventually be utilized, this change potentially has no long-run fiscal impact. Rather, the change likely provides for more timely use of credits obtained by taxpayers whose tax liabilities are not sufficient to exhaust the credits in one year. As a result, the bill could potentially lead to a significant short-term increase in the use of tax credits beginning in FY 2007 and FY 2008.

Background: The bill allows a taxpayer to transfer all or part of a state tax liability credit to another taxpayer beginning in tax year 2007. The bill requires transfers to be made by written instrument including the names of the transferor and transferee, a tracking number for the transfer generated by the Department of State Revenue, the type of state tax liability credit involved, and the credit amount being transferred. Since the bill is effective beginning in tax year 2007, the fiscal impact could potentially begin in FY 2007 if taxpayers who obtain unused tax credits in 2007 adjust their quarterly estimated payments. Pertinent tax credits that could be transferred under the bill are listed below.

1. Credit for income taxes paid to other states
2. Indiana College Contribution Credit
3. 21st Century Scholars Program Credit
4. Enterprise Zone Employment Expense Credit
5. Teacher Summer Employment Credits
6. Research Expense Credits
7. Prison Investment Credits
8. Enterprise Zone Loan Interest Credit
9. Neighborhood Assistance Credits
10. Enterprise Zone Investment Cost Credit
11. Industrial Recovery Tax Credit
12. Military Base Recovery Tax Credit
13. Military Base Investment Cost Credit
14. Economic Development for a Growing Economy Tax Credit
15. Capital Investment Tax Credit
16. Maternity Home Tax Credit
17. Tax Credit for Computer Equipment Donations
18. Historic Rehabilitation Credit
19. Indiana Riverboat Building Credit
20. Community Revitalization Enhancement District Tax Credit
21. Residential Historic Rehabilitation Credit
22. Rerefined Lubrication Oil Facility Credit

23. Voluntary Remediation Tax Credit
24. Venture Capital Investment Tax Credit
25. Coal Combustion Product Tax Credit
26. Hoosier Business Investment Tax Credit
27. Blended Biodiesel Tax Credits
28. Ethanol Production Tax Credit
29. Coal Gasification Technology Investment Tax Credit
30. Headquarters Relocation Tax Credit

Revenue from the corporate AGI Tax, the Financial Institutions Tax, and the Insurance Premiums Tax is distributed to the state General Fund. Revenue from the individual AGI Tax is deposited in the state General Fund (86%) and the Property Tax Replacement Fund (14%).

Hoosier Business Investment Tax Credit (HBITC): The bill makes the following two changes relating to the HBITC.

(1) The bill extends the sunset date for the HBITC by five years from December 31, 2007, to December 31, 2012. This would allow for new credits to be awarded by the IEDC for qualified investment occurring from 2008 to 2012. The bill also provides for automatic five-year extensions of the sunset date beginning December 31, 2012, unless legislation terminating the automatic extension is enacted. The potential amount of new credits that might be certified by the IEDC beginning in 2008 is indeterminable, with the fiscal impact of 2008 credits potentially beginning in FY 2009. A total of $331.7 M in new credits was awarded in 2004 (the first year of HBITC), and $149.6 M in new credits were awarded in 2005.

(2) The bill eliminates the deadline for creditable investment in machinery, equipment, or special purpose buildings used to make motion pictures or audio productions. The HBITC was extended to this type of investment effective May 15, 2005, but qualified investment must be made before January 1, 2008. The bill eliminates this deadline. The potential amount of new credits that might be certified by the IEDC for investment arising after the current deadline is indeterminable. The amount of new credits awarded in 2005 for qualified investment relating motion picture or audio production is unknown at this time.

_______***Background:*** Under current statute, the IEDC Board is authorized to award the nonrefundable HBITC for expenditures on qualified investment determined to foster job creation and higher wages in Indiana. The tax credit is equal to 10% of the qualified investment. (Note: The maximum allowable credit was 30% of qualified investment if approved before May 15, 2005.) A taxpayer may claim the credit against the AGI Tax, Insurance Premiums Tax, or Financial Institutions Tax liability. The tax credit may be approved only for qualified investment made during tax years 2004 to 2007. The credit is nonrefundable and may not be carried back. Unused tax credits may be carried over for up to nine years after the year in which the investment is made, unless a shorter carryover period is stipulated by the IEDC Board. A total of $331.7 M in new credits was awarded in 2004 for 54 projects consisting of $1,106.1 M in qualified investment. In 2005, $149.6 M in new credits was awarded for 58 projects consisting of $578.4 M in qualified investment.

Enterprise Zone (EZ) Investment Cost Credit (ICC): The bill extends the ICC to trusts, estates, corporations, and pass through entities effective beginning in tax year 2007. The ICC is currently available only to individuals making qualified equity investment in an EZ business, except in Vigo County where it is also available to pass through entities. While approximately $2.9 M in credits have been approved under the current ICC, the fiscal impact of extending to pass through entities and corporations is indeterminable.

Background : Under current statute, the ICC may be claimed against the AGI Tax by individuals purchasing an ownership interest (an equity investment) in an EZ business. Current statute allows pass through entities investing in businesses in a Vigo County EZ to claim the ICC. The bill extends the ICC to trusts, estates, corporations, and pass through entities for equity investment in any EZ.

Over the years $2.9 M in credits have been approved under the current structure of the ICC. Extending the ICC to taxpayers other than individuals could potentially increase the certification of new credits in future years. However, since data describing the investment behavior of EZ businesses is unavailable, the fiscal impact resulting from this change is indeterminable. Credits for investment that are encouraged by the change made under this bill presumably are not a revenue loss to the state. However, if the investment would have occurred in the absence of the change made by this bill, the net impact would be the total credits claimed by investors. The ICC is equal to a maximum of 30% of the equity investment. The credit percentage allowed (up to 30%) varies depending upon the type of investment, the type of business, and the number of jobs created. The credit is nonrefundable, but a taxpayer may carry over excess credits to subsequent taxable years.

Explanation of Local Expenditures:

Explanation of Local Revenues:

State Agencies Affected: Indiana Economic Development Corporation; Department of State Revenue.

Local Agencies Affected:

Information Sources: Claudia Ontiveros-Fuentes, IEDC, (317) 234-0616; Gretchen White, IEDC, (317) 234-3997. Karl Koehler, IEDC, (317) 234-1687. 21st Century Research and Technology Fund, *Fourth Report to the General Assembly: 2004-2005.*

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